Trump signals shift on "strong dollar"

Nick Beams
19 January 2017

Uncertainty about the direction of US economic policy has continued to grow in the lead up to the inauguration of Donald Trump as US president on Friday.

Earlier this week, in an interview with the *Wall Street Journal* (WSJ), Trump effectively abandoned the "strong dollar" mantra of previous US presidents. He insisted its value was too high, sending the US currency to a six-week low.

However, the dollar rebounded yesterday after Federal Reserve Board chairwoman Janet Yellen indicated in a speech delivered in San Francisco that the central bank was looking to go ahead with at least three interest rate hikes this year, following the 0.25 percentage point rise in December.

Trump's remarks to the WSJ were in line with his previous anti-China rhetoric and threats to impose tariffs on Chinese imports. "Our companies can't compete with them [China] now because our currency is too strong," he said. "And it's killing us."

Trump claimed, inaccurately, that the Chinese currency was "dropping like a rock." In fact, Chinese authorities are trying to maintain the value of the yuan in the face of large capital outflows from the country.

Yellen's speech consisted mainly of a broad-brush review of the official tasks of the Fed but it did contain some indications of where it is headed on monetary policy. This sparked an upward movement both of the dollar and interest rates in US bond markets.

Yellen said that at the Fed's meeting last month her view, and that of most other Fed members, was that the federal funds rate would be increased "a few times a year" until it reached its neutral rate in 2019. The neutral rate is regarded as the level at which monetary policy is neither expansionary nor contractionary.

In a further indication that the Fed is set on rate rises, she said: "Changes in monetary policy take time to work their way into the economy. Waiting too long to begin moving toward the neutral rate could risk a nasty surprise down the road—either too much inflation, financial instability, or both. In that scenario, we could be forced to raise interest rates rapidly, which in turn could push the economy into a new recession."

On the longer-term outlook for the US economy, Yellen said its usual rate of growth would now be "significantly lower than the post-World War II average."

She pointed to the slowdown in labour productivity growth, noting that it had increased only by about half a percentage point over the past six years and around 1.25 percent over the past decade, compared to the previous 30 years, when it rose by 2 percent per annum. This shift was reflected in the decline in the estimate for the neutral rate of interest to 3 percent, a percentage point lower than the estimate just three years ago.

Economists, she said, "do not fully understand the causes of the productivity slowdown" and then cited a possible range of factors, before concluding that whether or not they would continue to operate was an "open question."

A significant omission from her list of possible causes was the policies of the Fed itself and its injections of ultra-cheap cash into the financial system. These have promoted the growth of financial speculation and ever-increasing social inequality, accompanied by a decline in investment in the real economy.

Yellen's remarks on the future growth of the US economy point to some of the underlying forces driving Trump's increasingly trade war and protectionist statements, particularly directed against China. Under conditions of a slowdown in the US and world economy more broadly—a process that has already led to a significant fall in the rate of growth of international trade—the battle for market share is intensifying.

As a number of commentators remarked, Trump's comments to the WSJ were a significant departure from the policy stance of previous administrations over the past 20 years. They officially abided by the "strong dollar" policy, even when they wanted to see a fall in the currency.

University of California, Berkeley, economist and economic historian Barry Eichengreen, told the WSJ the strong dollar rhetoric was a way of not commenting on the value of the currency.

"Since the 1990s, if not before, all presidents and treasury secretaries have understood that to talk about the value of the single most important price in the global economy in terms that could be misunderstood can wreak havoc with the markets," he said.

Commenting on the exact value of the currency, he continued, was "like commenting on the circumstances under which you would use nuclear weapons."

While there is considerable unclarity about the exact shape of the incoming administration's policies, there is growing concern about the direction in which it is heading. According to Fred Bergsten of the Peterson Institute, China, Japan and Europe might be motivated to negotiate a currency agreement to avert growing protectionism in the US.

The formation of such currency blocs was one of the features of the decade of the 1930s, when the world market was fractured by the growth of trade war measures.

Fears of trade war will not have been lessened by comments from the billionaire businessman, Wilbur Ross, Trump's choice for commerce secretary, at his confirmation hearing before the US Senate yesterday.

Responding to the speech by Chinese President Xi Jinping at the annual meeting of the World Economic Forum in Davos on Tuesday, in which Xi advocated globalisation and free trade, Ross called China the "most protectionist" economy in the world. "They talk much more about free trade than they actually practice," he said.

As commerce secretary, Ross will have a major responsibility for implementing the "America First" agenda that Trump made the heart of his election campaign. Ross said he was not anti-trade but pro-sensible trade that did not disadvantage American manufacturing industry.

While claiming he was mindful of the lessons of the 1930s, when US-imposed tariffs worked to deepen the Great Depression, Ross added that "tariffs do have a useful role in correcting inappropriate policies." Among the measures touted by Trump during the election campaign were a 45 percent tariff on Chinese imports and a 35 percent "border tax" on imports from Mexico.

When tariffs were imposed in the 1930s, each side sought to blame the other for measures that worsened the state of the global economy. There was more than an element of that rhetoric in Ross' remarks.

"It's a little weird that we have very low tariffs and China has very high tariffs. That seems to me to be a bit of an imbalance. It is one thing to talk about free trade. We would like our trading partner to practice more free trade," he said.